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Message Text

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EB-08 FRB-01 INR-07 NSAE-00 USIA-15 XMB-04
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STR-04 CEA-01 PA-02 PRS-01 /121 W
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P R 071517Z SEP 77
FM AMEMBASSY LONDON
TO SECSTATE WASHDC PRIORITY 8036
TREASURY DEPT WASHDC PRIORITY
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY DUBLIN
AMEMBASSY PARIS
AMEMBASSY ROME
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USECC ALSO FOR EMBASSY
USOECD ALSO FOR EMBASSY
USMTN

DEPARTMENT PASS FEDERAL RESERVE BOARD; TREASURY FOR
DONALD E. SYVRUD, OASIA

E.O. 11652: N/A
TAGS: ECON, UK
SUBJECT: ECONOMIC DEVELOPMENTS FOR PERIOD SEP 1-7

SUMMARY: THIS WEEK'S STATISTICS SHOW A MIXED PICTURE, WITH A RECOVERY IN RETAIL SALES, BUT WITH CAUTION RATHER
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THAN OPTIMISM SEEN IN THE BUSINESS COMMUNITY. AUGUST BANKING STATISTICS SHOW THAT FUNDS ARE AVAILABLE FOR LENDING, BUT WITH NO PICKUP IN PRIVATE SECTOR DEMAND, DUE PERHAPS TO SEASONAL INFLUENCES. PUBLIC SECTOR BORROWING IS ON TARGET. RESERVES CONTINUED TO INCREASE AS STERLING HAD A GENERALLY QUIET WEEK. MOST EYES WERE FIXED ON BLACKPOOL AS THE PRIME MINISTER AND THE TUC EX-

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PRESSED VIEWS ON THE APPROPRIATE FUTURE LEVEL OF WAGES.
END SUMMARY

1. THE MAJOR NEWS ITEM THIS WEEK IS THE CONTINUING SERIES OF STATEMENTS FROM THE PRIME MINISTER AND CHANCELLOR ON THE NEED FOR WAGE DISCIPLINE AND FOR COMPANIES TO HOLD THE LINE ON LIMITING WAGE INCREASES. PRIME MINISTER CALLAGHAN DELIVERED A SIMPLE AND TOUGH SPEECH TO THE TRADES UNION CONGRESS ON SEPTEMBER 6 IN WHICH HE WARNED THAT IF COOPERATION BETWEEN THE UNIONS AND THE LABOUR GOVERNMENT WITHERED AWAY, THERE WOULD BE A CONFRONTATION OVER PAY AND BOTH SIDES WOULD BE THE LOSERS. CALLAGHAN HINTED THAT THERE COULD BE REFLATIONARY MEASURES THIS AUTUMN, BUT THAT REFLATION WOULD NOT JUST BE A PRE-ELECTION SPRINT TO TRY TO DECEIVE THE ELECTORATE (SEE SEPTEL).

2. THE FINANCIAL TIMES MONTHLY SURVEY OF BUSINESS OPINIO FOR MAY-AUGUST, PUBLISHED SEPTEMBER 5, SHOWS THAT INDUSTRIAL CONFIDENCE REMAINS SOMEWHAT UNCERTAIN, BASICALLY UN CHANGED SINCE APRIL-JULY, BUT GENERALLY LESS OPTIMISTIC THAN IN MARCH-JUNE CONCERNING PROSPECTS FOR THE UK ECONOMY. COMPANIES QUESTIONED GENERALLY ARE MORE OPTIMISTIC ABOUT EXPORT PROSPECTS, BUT SEE ONLY SLOW RECOVERY IN DEMAND. THE MAIN FACTOR HOLDING BACK PRODUCTION IS A SHORT AGE OF DOMESTIC ORDERS, BUT THERE IS ALSO A NOTICEABLE
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INCREASE IN THE NUMBER OF COMPANIES MENTIONING LABOR DISPUTES AND SHORTAGES OF SKILLED STAFF.

THERE WAS LITTLE EXPECTATION OF AN EARLY INCREASE IN EMPLOYMENT WITH A ROUGH BALANCE BETWEEN COMPANIES EXPECTING TO INCREASE LABOR FORCE IN THE NEXT 12 MONTHS (18 PERCENT) OR REDUCE IT (19 PERCENT). THERE IS ALSO A NOTICEABLE DECLINE IN PROJECTED VOLUME INCREASES IN CAPITAL EXPENDITURE (46 PERCENT IN MAY-AUGUST, AGAINST 52 PERCENT AND 59 PERCENT RESPECTIVELY IN APRIL-JULY AND MARCH-JUNE).

ONLY 17 PERCENT OF THOSE QUESTIONED EXPECTED WAGES TO INCREASE BY LESS THAN 10 PERCENT IN THE COMING YEAR; 44 PERCENT OF RESPONDENTS SEEING WAGES INCREASING IN THE 10 TO 14 PERCENT RANGE. SIXTY SEVEN PERCENT OF RESPONDENTS EXPECTED UNIT COSTS TO INCREASE FROM 10 TO 19 PERCENT. WHILE EXPORT PROSPECTS REMAIN STRONG, THERE IS A GREATER INCLINATION TO MENTION PRICE COMPETITION AND EROSION OF THE EXCHANGE RATE ADVANTAGE FOLLOWING

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TO SECSTATE WASHDC PRIORITY 8037
TREASURY DEPT WASHDC PRIORITY
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THE STABILITY OF STERLING.

3. THE PRICE COMMISSION, WHICH KEEPS AN INDEX OF NOTIFIED PRICE INCREASES, REPORTS A SHARP DOWNTURN IN RECENT MONTHS. THE COMMISSION'S OWN INDEX OF PRICE RISES, REPORTED TO IT BY MANUFACTURERS AND RETAILERS, BASED ON SIX MONTHS' FIGURES AT AN ANNUAL RATE, SHOWS AN 11.7 PER CENT INCREASE THROUGH AUGUST, COMPARED WITH 14.5 PERCENT IN JULY AND 15.1 PERCENT IN JUNE. THE INDEX USUALLY PRECEDES RETAIL PRICE INDEX (RPI) MOVEMENTS BY 3 TO 4 MONTHS.
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4. THE CENTRAL STATISTICAL OFFICE REPORTS THAT THE PUBLIC SECTOR BORROWING REQUIREMENT FOR APRIL TO JUNE (THE FIRST QUARTER OF THE FISCAL YEAR) WAS 1.7 BILLION POUNDS SEASONALLY ADJUSTED. THIS IS 385 MILLION POUNDS LOWER THAN IN THE PREVIOUS THREE MONTHS AND IS THE LOWEST QUARTERLY FIGURE FOR THREE YEARS. IT IS EQUIVALENT TO AN ANNUAL RATE OF 6.85 BILLION POUNDS, WHICH PROBABLY UNDERSTATES THE UNDERLYING TREND BECAUSE THE APRIL-JUNE FIGURES DO NOT TAKE ACCOUNT OF THE CONDITIONAL INCOME TAX CHANGES IMPLEMENTED IN THE CURRENT QUARTER. THESE TAX CUTS MIGHT BOOST THE BORROWING REQUIREMENT TO 7-3/4 BILLION POUNDS - 8 BILLION.

ONE OF THE PRINCIPAL REASONS FOR THE REDUCTION IN THE PSBR WAS THE PERFORMANCE OF THE LOCAL AUTHORITIES. PREVIOUSLY, WHEN INTEREST RATES WERE MUCH HIGHER, THEY WERE HEAVY BORROWERS IN THE SHORT-TERM MONEY MARKETS. THEY DID NOT WANT TO BE LOCKED INTO LONG-TERM LOANS AT HIGH RATES OF INTEREST. RECENTLY LOCAL AUTHORITIES HAVE SHARPLY INCREASED THEIR BORROWING FROM CENTRAL GOVERNMENT AND ACTUALLY REPAID LOANS FROM OUTSIDE SOURCES. THE EFFECT OF THIS IS TO RAISE THE DEFICIT OF CENTRAL GOVERN-MENT BUT REDUCE THE LOCAL AUTHORITIES' CONTRIBUTION TO THE OVERALL PUBLIC SECTOR DEFICIT. HOWEVER, THIS SHIFT IN BORROWING HAS BEEN ABSORBED BY CENTRAL GOVERNMENT WITH OUT UNDULY RAISING ITS OWN DEFICIT -- PARTLY BECAUSE OF THE EXTRA MONEY GAINED FROM THE GOVERNMENT'S SALE OF SOME OF ITS HOLDINGS IN BRITISH PETROLEUM.

MILLION POUNDS SEASONALLY ADJUSTED

FINANCIAL YEAR	TOTAL CENTRAL GOVERNMENT	(1)GENERAL PUBLIC SECTOR	GOVERNMENT REQUIREMENT
1975-76	8,803	10,629	10,125

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1976-77	5,944	8,83L	7,384
1975-76 Q3	1,966	2,679	2,371
Q4	1,785	2,596	2,478
1976-77 Q1	2,118	2,838	2,327
Q2	1,769	2,137	1,812
Q3	511	1,759	1,124
Q4	1,546	2,097	2,121
1977-78 Q1	1,723	1,712	1,295

(1) GENERAL GOVERNMENT BORROWING REQUIREMENT COMPRISES THE CENTRAL GOVERNMENT BORROWING REQUIREMENT AND THE LOC AUTHORITIES' CONTRIBUTION TO THE PSBR, PLUS BORROWING FOR ON-LENDING TO PUBLIC CORPORATIONS. IT EXCLUDES PUBLIC CORPORATIONS' CONTRIBUTION TO THE PSBR. THIS DEFINITION OF THE GOVERNMENT'S BORROWING REQUIREMENT IS MORE COMPARABLE TO THAT USED IN MANY OTHER COUNTRIES.

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5. RETAIL SALES IN JULY. THE FINAL SEASONALLY ADJUSTED INDEX OF THE VOLUME OF RETAIL SALES IN JULY IS 107.0, A LITTLE LOWER THAN THE PROVISIONAL ESTIMATE OF 107.50, BUT STILL WELL ABOVE THE LEVEL OF RECENT MONTHS. THE RECOVERY IN JULY IS CONCENTRATED IN THE SALES OF NON-FOOD SHOPS WHERE TRADE MAY HAVE BEEN INFLUENCED BY COMPARATIVELY BUOYANT ANNUAL 'SALES' AND BY THE POSTPONEMENT THIS YEAR OF SOME 'SALES', PARTICULARLY IN CENTRAL LONDON FROM JUNE UNTIL JULY. THERE WAS ALSO A SHARP INCREASE IN RETAILERS' INSTALMENT CREDIT LENDING IN JULY. IN THE THREE MONTHS MAY TO JULY THE VOLUME OF TOTAL TRADE WAS 1 PERCENT HIGHER THAN IN THE PREVIOUS THREE MONTHS. FOR THE MAIN COMPONENTS OF TOTAL TRADE, THE VOLUME OF SALES BY DURABLE GOODS SHOPS WAS 4 PERCENT HIGHER THAN IN THE PREVIOUS THREE MONTHS. SALES BY CLOTHING AND FOOTWEAR SHOPS WERE LITTLE CHANGED WHILE SALES BY "OTHER NON-FOOD" SHOPS, WHICH INCLUDE DEPARTMENT STORES AND MAIL ORDER BUSINESSES, ROSE BY 1 PERCENT. SALES BY FOOD SHOPS WERE LITTLE CHANGED BETWEEN THESE PERIODS.

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INFO AMEMBASSY BONN
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6. HIRE PURCHASE AND OTHER INSTALMENT CREDIT BUSINESS I JULY 1977. NEW INSTALMENT CREDIT ADVANCED BY FINANCE HOUSES AND RETAILERS AMOUNTED TO 363 MILLION POUNDS IN JULY (SEASONALLY ADJUSTED). WITHIN THIS TOTAL, FINANCE HOUSES' LENDING WAS VIRTUALLY THE SAME AS IN JUNE AND RETAILERS' LENDING SHOWED A MARKED INCREASE. (AS NOTED, TOTAL RETAIL SALES IN JULY ALSO SHOWED A MARKED INCREASE. IN THE LATEST THREE-MONTH PERIOD, MAY TO JULY 1977, TOTAL ADVANCES BY FINANCE HOUSES AND RETAILERS WERE 3 PERCENT UP ON THE PREVIOUS THREE MONTHS, FEBRUARY TO APRIL. FINANCE
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HOUSES' LENDING INCREASED BY 4 PERCENT BETWEEN THESE TWO PERIODS AND RETAILERS' LENDING BY 2 PERCENT. THE AVERAGE WEEKLY VALUE OF RETAILERS' INSTALMENT CREDIT SALE IN JULY WAS SUBSTANTIALLY HIGHER THAN IN PREVIOUS MONTHS. CREDIT SALES BY DURABLE GOODS SHOPS WERE 5 PER-CENT HIGHER DURING THE THREE MONTHS MAY TO JULY THAN IN THE PRECEDING THREE MONTHS. SALES BY DEPARTMENT STORES FELL BY 2 PERCENT AND THOSE BY OTHER INSTALMENT CREDIT RETAILERS (INCLUDING MAIL-ORDER HOUSES) INCREASED BY 2 PERCENT BETWEEN THE TWO THREE-MONTHLY PERIODS.

7. REFLECTING IN PART THE SUSPENSION OF THE CORSET, THE U.K. BANKING STATISTICS FOR THE BANKING MONTH ENDING AUGUST 17 SHOW AN INCREASE IN RESERVE RATIOS AND IN ELI-GIBLE LIABILITIES.

SOME SEASONAL ELEMENT MAY AFFECT THE FIGURES, WHICH SHOW A 1.5 PERCENT INCREASE IN ELIGIBLE LIABILITIES AND A 2.6 PERCENT INCREASE IN IBELS. MOST OBSERVERS BELIEVE THAT NEXT WEEK'S STERLING M3 FIGURES WILL SHOW GROWTH WITHIN THE 9-13 PERCENT TARGET RANGE, THE CLEARING BANKS REPORTING LITTLE GROWTH IN LENDING.

STATISTICS RELEASED ON ELIGIBLE LIABILITIES, RESERVE ASSETS, RESERVE RATIOS AND SPECIAL DEPOSITS:

(IN MILLIONS OF POUNDS

	JULY 20	AUG. 17
ELIGIBLE LIABILITIES	37,087	37,691

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OF WHICH INTEREST BEARING		
(IBEL'S)	24,663	25,316
RESERVE ASSETS	5,192	5,467
OF WHICH:		
MONEY AT CALL IN THE DISCOUNT		
MARKET	1,842	2,233
UK AND NORTHERN IRELAND		

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TREASURY BILLS	1,337	1,259
BALANCE WITH THE BANK OF		
ENGLAND	384	278
BRITISH GOVERNMENT STOCKS UP		
TO 12 MONTHS	618	676
RESERVE RATIOS (PERCENT)	14.0	14.5

8. IMPORTED CARS, INCLUDING IMPORTS OF VEHICLES BUILT IN EUROPE BY THE MAIN UK MANUFACTURERS, TOOK 50.76 PERCENT OF THE UK'S AUGUST SALES. A SHORTAGE OF HOME-PRODUCED VEHICLES, CAUSED PARTLY BY INDUSTRIAL DISPUTES, COINCIDED WITH THE START OF A NEW REGISTRATION YEAR, AND IMPORTERS HAD THE CARS TO MEET DEMAND. NO IMPROVEMENT FOR DOMESTIC-PRODUCED CARS IS FORESEEN IN SEPTEMBER BECAUSE OF THE STRIKE OF ONE OF LEYLAND'S MAJOR SUPPLIER

9. UK OFFICIAL RESERVES ROSE $1,430 MILLION IN AUGUST, TO REACH $14,852 MILLION. THE INFLOW INCLUDED $100 MILLION FROM THE SECOND TRAUCHE OF THE HMG $1.5 BILLION EURODOLLAR LOAN, AND A DRAWING OF $374 MILLION ON THE IMF STANDBY. THE UNDERLYING INCREASE WAS $956 MILLION. THE REMAINING $400 MILLION OF THE EURODOLLAR BORROWING AND $100 FROM A NATIONAL COAL BOARD EUROBOND ISSUE WILL BE ADDED TO SEPTEMBER'S RESERVES. A LARGE PART OF THE INFLOW REPORTEDLY CAME FROM VOLATILE MONETARY FLOWS IN EARLY AUGUST, WITH SOME REDUCTION IN SUCH MOVEMENTS SINCE THEN.

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10. STERLING HAD, TO QUOTE ONE DEALER, "A QUIET WEEK, WITH RIPPLES". AS NEGATIVE NEWS CAME FROM THE TUC CONFERENCE IN BLACKPOOL, IT WAS REFLECTED IN THE FORWARDS, RATHER THAN IN SPOT. THERE IS SOME MARKET SPECULATION THAT ONCE THE TUC/POLITICAL CONFERENCE PERIOD IS OVER, STERLING MAY BE ALLOWED TO FLOAT UPWARDS AGAIN. ONE DEALER SUGGESTS THAT RESERVES THIS MONTH WILL BE AIDED BY MATURING FORWARD CONTRACTS. THERE ARE REPORTS THAT SOME U.S. BANKS ARE TAKING A MORE JAUNDICED VIEW OF STERLING. OTHERS ARE MORE CAUTIOUSLY OPTIMISTIC, PRO-
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VIDED THE GOVERNMENT CAN HOLD A REASONABLE LINE ON PUBLIC SECTOR WAGE INCREASES.

11. EXCHANGE RATE AND GOLD

DATE	EXCHANGE RATE	EFFECTIVE EXCHANGE RATE (DEC. 1971) EQUALS 100)	GOLD ($)
8/31	1.7429	62.3	145-7/8
9/1	1.7423	62.3	145-5/8
9/2	1.7419	62.3	146-3/8
9/5	1.7413	62.3	147-7/8

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9/6 1.7413 62.3 147-3/8
CHANGE 8/30-9/6 DOWN .0010 UNCHANGED UP 1.00

12. FORWARD DISCOUNT ON STERLING

DATE	1 MONTH	3 MONTHS	6 MONTHS
8/31	0.19	0.52	1.225
9/1	0.09	0.44	1.055
9/2	0.09	0.47	1.175
9/5	0.12	0.67	1.40
9/6	0.15	0.62	1.30

CHANGE 8/30-9/2 WIDER 0.03 NAR 0.18 WIDER 0.045
(ALL FIGURES IN CENTS)

13. EURODOLLAR INTEREST RATES

DATE	1 MONTH	3 MONTHS	6 MONTHS
8/31	5-7/8	6-1/4	6-1/2
9/1	6-1/4	6-3/8	6-5/8
9/2	6-1/4	6-3/8	6-5/8
9/5	6-5/8	6-3/8	6-5/8
9/6	6-1/8	6-3/8	6-1/2

CHANGE 8/30-9/6 UNCHANGED UNCHANGED DOWN 1/8

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14. THREE-MONTH LONDON INTERBANK - EURODOLLAR INTEREST RATE DIFFERENTIAL

DATE	
8/3L	15/32
9/1	5/16
9/2	5/16
9/5	9/32
9/6	7/32

CHANGE 8/30-9/6 NAR. 3/32

15. STERLING CERTIFICATES OF DEPOSIT

DATE	1 MONTH	3 MONTHS	6 MONTHS
8/31	6-5/8	6-5/8	7-1/32
9/1	6-5/8	6-21/32	7
9/2	6-9/16	6-9/16	6-31/32
9/5	6-9/16	6-9/16	6-15/16
9/6	6-9/16	6-9/16	6-25/32

CHANGE 8/30-9/6 DOWN 1/32DOWN 1/16 DOWN 7/32

16. THE MINIMUM LENDING RATE WAS UNCHANGED AT 7 PERCENT. THE TREASURY BILL AUCTION RATE FELL BY 0.1141 TO 6.3043 PERCENT. THE 450 MILLION POUNDS IN BILLS OFFERED ATTRACTED BIDS OF 1,050.4 MILLION POUNDS. THIS WEEK WILL SEE 350 MILLION POUNDS IN BILLS OFFERED TO REPLACE MATURITIES OF 300 MILLION POUNDS.

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Secure: OPEN
Status: NATIVE
Subject: ECONOMIC DEVELOPMENTS FOR PERIOD SEP 1-7 SUMMARY: THIS WEEK\'S STATISTICS SHOW A MIXED PICTURE, WITH A RECOVERY IN RETAIL SALES, BUT WITH CAUTION
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To: STATE TRSY
Type: TE
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